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SUBJECT: EMBASSY AND GON HOST COMPETITIVENESS FORUM

Summary

1. (SBU) The Embassy and Ministry of Trade, Industry, and Commerce (MIFIC) co-hosted a day-long "National Forum on Competitiveness and Investment" on May 28, 2008, in Managua, Nicaragua. The forum, which served as a prelude to Secretary Gutierrez' Americas Competitiveness Forum (ACF), scheduled for August 17-19 in Atlanta, inspired debate and recommendations on topics such as financing for small businesses and their incorporation in national and international value chains. Participants also discussed institutional factors that contribute to competitiveness, such as weaknesses in Nicaragua's rule of law. However, Vice President Jaime Morales Carazo privately questioned the importance of these factors. Deputy Assistant Secretary of Commerce Walter Bastian encouraged Nicaraguans to participate in the ACF and continue dialogue on competitiveness issues, while Deputy Assistant Secretary of Treasury Brian O'Neill described programs on small business financing and infrastructure development.

EEB/CBA BFIF Funding Supports Forum

2. (U) With funding from the EEB/CBA Business Facilitation and Incentive Fund (BFIF), the Embassy and Ministry of Trade, Industry, and Commerce (MIFIC) co-hosted a "National Forum on Competitiveness and Investment" on May 28, 2008, in Managua, Nicaragua. Working with MIFIC officials, Econoffs developed that agenda, invited and briefed speakers, and provided overall logistical support. Over 150 Nicaraguan government officials and private sector representatives attended the day long event. Econoffs are now working with business leaders to organize a second forum that would address competitiveness issues from their perspective.

Ambassador Describes the "Investment Calculus"

3. (U) Ambassador Trivelli opened the forum by describing the "investment calculus" -- factors a company takes into consideration when deciding where to make an investment, such as the importance of rule of law, regulatory quality, and infrastructure. He noted the importance that Nicaragua's leadership send a clear message that investment is welcome as part of the country's efforts to create jobs and alleviate poverty. The Ambassador concluded by describing the importance of innovation and productivity gains in allowing the private sector to serve as the engine of economic growth.

Vice President Criticizes Savage Capitalism and Socialism

4. (U) Vice President Morales followed with remarks emphasizing

positive areas of engagement between the United States and Nicaragua, including the role of CAFTA-DR in job creation and export growth. Morales acknowledged local criticism of free market economics and suggested that this was because the "neo-liberal" economic model has not been successful in alleviating poverty. However, he also discredited socialist alternatives, alluding to the "catastrophic effects" of the Sandinista economic policies of the 1980s. He observed that both capitalism and socialism taken to their extremes are "savage," but defended the leading role of government in safeguarding public interests. [Comment: The Vice President was attempting to balance President Ortega's frequent criticism of "savage" capitalism by framing it in a context that Ortega has not -- that is, all ideological extremism is dangerous. End comment.] Returning to the theme of competitiveness, he listed factors such as infrastructure, education, and macroeconomic stability as key to efforts to "combat poverty through job creation and private investment, both foreign and domestic."

Vice President Questions Rule of Law Indicators

15. (SBU) During a pull-aside with Vice President Morales, DAS Bastian highlighted the upcoming ACF in Atlanta, stating that he hoped to identify a "Nicaraguan project" that can be funded at the Forum as a deliverable. [Note: The Vice President will, as he did last year, lead the Nicaraguan delegation, which will also include MIFIC Minister Solorzano and Presidential Delegate for Investment Promotion Alvaro Baltodano, who also participated in the pull-aside. End note.] DAS O'Neill emphasized the importance of Nicaragua staying on track in its economic and financial programs and identified the need to negotiate a solution to a government debt default related to bonds issued to resolve a banking crisis in 2001 (septel). Both USG officials emphasized that ideological rhetoric critical of market economics and private investment is not helpful. At some point, "perception is reality."

16. (SBU) Ambassador Trivelli added that weak rule of law drags down Nicaragua's rankings in international business and competitiveness indicators and hinders the country's efforts to attract investment. Vice President Morales responded that actions speak louder than words. He reasserted that international indicators such as the World Economic Forum (WEF) Global Competitiveness Index are based on perception and, therefore, unimportant. He highlighted China's high growth rate, despite extensive corruption, as an example of why indicators and rankings do not matter. The Vice President went on to disparage the United States for attempting to "impose standards that do not fit the realities of this country." DAS Bastian closed the conversation by suggesting that instead of arguing about the validity of indicators and rankings, Nicaragua should "develop a long-term vision of its future -- Where does it want to be in 30 years, and what kind of economy does it want to have?"

INCAE Dean: Focus on Competitiveness Indicators

17. (U) Niels Ketelhohn, Dean of the INCAE Business School in Managua, provided a general macroeconomic overview, noting the risk that inflation, forecast by some economists to reach 22% for 2008, poses to economic stability. He also underscored the importance of exports to Nicaragua's economic development and highlighted growing Nicaraguan trade with the United States, which accounts for more than 50% of total exports. Ketelhohn told the audience that many of Nicaragua's poor would bear the brunt of rising food prices but that net producers of agricultural products stand to benefit. He referred to the WEF Global Competitiveness Index, where Nicaragua currently ranks 111th of 131 countries (worse than Albania but slightly better than Burkina Faso), to describe weaknesses in Nicaragua's investment climate. Ketelhohn noted that Nicaragua ranks especially low in judicial independence (129th), port infrastructure (124th); and education (123rd). In conclusion, he reminded participants that, "the aspiration to lift our people out of poverty is rooted in the success of the private sector."

Private Sector: Rule of Law Does Matter

18. (U) Jose Adan Aguerri, President of the Federation of Nicaraguan Business Associations (COSEP), also focused on the WEF Global

Competitiveness Index, listing additional weaknesses for Nicaragua such as access to credit (121st), competition policy (129th), and technology transfer (126th). He also identified advantages, such as Nicaragua's flexible labor laws (26th), the ease of opening a business (16th), and rules governing profit repatriation (21st). Aguerri moved on to political issues, describing the negative impact the government's public discourse has on the investment climate. He specifically mentioned the negative impact "judicial uncertainty" has had on the investment climate, and lamented delays in approving laws important to the investment climate, such as the Coastal Law. He concluded with an overview of COSEP's "Pillars of Development," an export-led growth strategy that includes industry specific initiatives as well as an active role for government in meeting the country's infrastructure, financing, and education needs. He highlighted the role of COSEP in opening channels of communication with the government, but admitted limited progress on proposed initiatives.

Small Business Success Stories

¶9. (U) Paul Davidson, Operations Manager for AGORA Partnerships, described his business model as one of identifying entrepreneurs eager to grow their business, providing technical assistance, and offering financing through direct equity stakes. AGORA Partnerships, with support from the U.S. Agency for International Development, has provided technical assistance to 47 firms and venture capital to five companies. Carlos Solorzano, owner of VegyFrut, a company in which AGORA has invested, illustrated the growth his firm has sustained by working with AGORA Partnerships. Founded in 2006, VegyFrut, now processes daily 4,000 pounds of fresh fruits and vegetables for local and regional clients, including for U.S. franchises such as McDonald's and Quiznos.

¶10. (U) Merling Preza, General Manager of coffee cooperative PRODECOOP, described the cooperative's transformation since it was founded by 20 small farmers in 1993. The cooperative is now one of the most successful producers of fair trade coffee in Nicaragua, earning its members a 22% price premium on sales for the 2006-07 harvest. Preza said the cooperative has focused on investment in key infrastructure to improve quality control and provided technical assistance to members to improve their farming practices. Preza credited PRODECOOP's success to efforts made to understand the full value chain for coffee and meet buyers' needs.

¶11. (U) Armando Fernandez, President of the CAMPOAPAN dairy cooperative, described the success he and 24 other dairy farmers have had since 1991 when they founded the cooperative to process and distribute their milk products. With support from the U.S. Department of Agriculture to improve quality and safety, the plant is now U.S. FDA certified, and in 2007 the cooperative exported \$3.6 million in dairy products to the United States. Fernandez highlighted CAMPOAPAN's efforts to introduce new technology in farming and processing, but noted that poor road infrastructure and the high cost of working capital still limit growth for his and many others cooperatives.

Panel Discusses Value Chain for Small Businesses

¶12. (U) Jorge Brenes, General Manager of Nicaragua's Export and Producers Association (APEN), observed that many sectors continue to grow despite the competitive disadvantages that many businesses face in Nicaragua. As an example, he noted that bean production continues to increase at an annual rate of 12%. Brenes asserted that market forces are driving this growth; if producers are quick to respond to increasing demand, they can take advantage of rising food prices and other market opportunities. Alberto Pereira, General Manager of Hortifruti, the fresh fruit and vegetable division of Wal-Mart - Nicaragua, described his company's efforts to help small producers through technical assistance and financing provided in cooperation with partners such as the U.S. Agency for International Development.

¶13. (U) In response to an audience question on government initiatives to support small businesses, Guillermo Lopez, Director of Small Business Development at MIFIC, described MIFIC's work with the World Bank, the United Nations Industry Development

Organization, and other donors to design programs that support the establishment of an effective agro-industrial policy that includes assistance for small farmers so that they may better participate in value chains. MIFIC also plans to continue support for a Bolanos administration effort that provided support for economic clusters, encouraging technology transfer and productivity gains among related firms.

¶14. (U) Jaime Arguello, Director of FINCA - Nicaragua, a microfinance organization supported by the U.S. Department of Agriculture, answered several questions on financing options available for small businesses, particularly in the agricultural sector. Arguello told the audience that his organization continues to support lending practices that place more weight on the development of a coherent business plan than the quality of collateral; however, he recognized that, in general, interest rates remain relatively high, around 20%, and terms on most loans are less than a year. Pedro Haslam, President of the Nicaraguan Federation of Agro-industrial Cooperatives (FENIAGRO), shared experiences from the borrower's perspective, corroborating the difficulties identified by Arguello. He added that in order to obtain credit, farmers must be able to increase productivity.

DAS Bastian Invites Nicaraguans to the ACF

¶15. (U) Commerce DAS Walter Bastian congratulated MIFIC for organizing the forum, noting that the event provides an excellent opportunity to learn from others on how to improve competitiveness. He urged participants to recognize the importance of competitiveness as part of the Nicaraguan economic agenda. He extended a general invitation to Secretary Gutierrez' Americas Competitiveness Forum to be held in Atlanta, August 17 - 19, for discussions on themes such as trade logistics, renewable energy, education, and tourism. Bastian announced that Secretary Gutierrez plans to visit Nicaragua after the ACF, perhaps in late September.

¶16. (U) Bastian stressed the importance of free trade agreements such as CAFTA-DR, which has helped increase Nicaraguan exports by 35% since its inception in 2006. He noted that Nicaragua has benefited more than any other Central American country, thanks in large part to Cone Denim's \$100 million investment, the largest foreign investment in the region since the implementation of the treaty. For U.S. businesses, trade with countries that have signed agreements with the United States represents 90% of U.S. trade in the hemisphere and over 40% of U.S. trade around the world.

DAS O'Neill Briefs on SME and Infrastructure Initiatives

¶17. (U) Treasury DAS Brian O'Neill briefed participants on two Treasury initiatives that support competitiveness in Latin America. In July 2007, Treasury launched the Latin American Infrastructure Development Program, in partnership with the International Finance Corporation of the World Bank, to fund feasibility studies in support of private investment in infrastructure. Together, they have contributed \$12 million (including \$4.6 million from the USG) to the program to date, with another \$8 million slated over the next two years. O'Neill told attendees that the program targets three constraints that discourage private investment in infrastructure, that is, lack of reliable information on good projects for potential investors, unfamiliarity with ways to structure and tender projects, and problems with the regulatory environment. To date, the initiative has committed \$1.3 million for 12 feasibility studies, on projects that have the potential to attract \$2.6 billion in infrastructure investment.

¶18. (U) O'Neill told participants that Treasury launched the Latin America Small Business Lending Initiative in June 2007. The effort to expand and improve access to commercial financing for small businesses is taking place through a three-part initiative. The Inter-American Development Bank (IDB) Multilateral Investment Fund is providing technical cooperation grants and loans to local banks. The U.S. Overseas Private Investment Corporation is offering guarantees and loans to banks that work with small businesses. Treasury's Office of Technical Assistance is targeting Latin American countries in the design and implementation of regulations and oversight of credit providers to small businesses. O'Neill

explained that the IDB has committed \$10 million to the initiative, including \$500,000 lent to local bank BANCENTRO in November 2007. OPIC has committed \$150 million, and already approved \$52 million, in loans to banks throughout the region as part of the initiative.

Private Sector on Food Crisis and Nicaraguan Response

¶19. (U) Mario Amador, President of the National Council of Sugar Producers (CNPA) remarked on the challenges and opportunities facing agro-industry as a result of the emerging food crisis caused by rising energy costs, the use of arable land to produce biofuels, climate change, developed-country agricultural subsidies, market speculation, rising food demand in China and India, and a lack of agricultural productivity growth. He noted that several large agricultural producers have responded by imposing export restrictions. In the case of Central America, Amador observed countries increasingly depend on food imports, especially rice, to meet internal demand, and very few countries are net exporters.

¶20. (U) Amador noted that unlike many other countries, for Nicaragua the food crisis represents an opportunity to become an important food supplier for the region and beyond. He called for renewed efforts to increase agricultural productivity through the introduction of new plant varieties, including those developed through biotechnology; improved access to financing, especially for small farmers; and greater public investment in infrastructure. He added that "the cornerstone of any effort to increase agricultural production is a judicial system that provides legal certainty to farmers, especially when it comes to land titling, and to all other members of the value chain, regardless of their size."

GON View on Competitiveness and Investment Promotion

¶21. (U) Alvaro Baltodano, Presidential Delegate for Investment Promotion, told the audience that private and public investment is the foundation of Nicaragua's development strategy. He reasoned that "it is investment that encourages improvements in competitiveness." He said the government's role in this context is to foster investment in health and education, promote employment, develop transportation and other economic infrastructure, and protect the environment. In particular, he noted government efforts to increase geothermal and hydroelectric production throughout the country. He also mentioned the government's intention to develop ports on the Atlantic coast, including a deep water port at Monkey Point and a highway along the Pacific coast

¶22. (U) Baltodano highlighted the efforts of ProNicaragua, the government's investment promotion agency, to attract investment in the agro-industrial sector, including milk, meat, and bean processing and the cultivation and processing of African palm and other biofuels. He commented on efforts to attract logistics and assembly operations and technology firms. Baltodano mentioned efforts to incorporate small businesses into value chains.

Panel Discussion on Investment and Competitiveness

¶23. (U) Alejandro Martinez Cuenca, President of the International Foundation for the Global Economic Challenge (FIDEG), described competitiveness as "improving factors important to productivity gains, which, in turn, are the basis of economic growth." He decried Nicaragua's weaknesses regarding respect for private property and judicial independence. Martinez claimed that principled leadership and open communication are essential to attracting investment to Nicaragua. He offered Vietnam as an example of a country with a similar history but very different economic trajectory, with annual growth averaging 7.5% for the last ten years. In the last three years, Nicaragua's growth has declined from 4% to 2.5%. Martinez asked rhetorically, "Why is Vietnam growing and not Nicaragua?"

¶24. (U) Rodrigo Caldera, Senior Advisor for ARENECOM, a Japanese-Mexican manufacturer of automobile wiring harnesses, shared the perspective of a foreign investor that competes worldwide from its base in Nicaragua. He suggested that the government should play a more active role in facilitating business. He stressed the

importance of 24-hour customs service for his business, since ARNECOM ships all of its products by land because ocean shipping is limited in Nicaragua. He said that power outages not only affect production, but also damage costly equipment. In conclusion, he urged the government to provide consistent and clear rules for business and to continue to invest in infrastructure improvements.

¶25. (U) Juan Bugna, a past President of the National Tourism Chamber of Commerce (CANTUR), discussed the risk that investors in tourism projects face. Risk is exacerbated by the lack of clear rules, such as the pending Coastal Law, which would strengthen coastal property rights. To attract more investment to the sector, Bugna believes the government must build basic infrastructure, not just provide fiscal incentives to the individual investor -- because whatever an investor saves on taxes, he later spends on compensating for power outages or water shortages. Bugna called for effective dialogue between the public and private sector to address these and other issues related to competitiveness.

IDB Support for Private Sector Investment

¶26. (U) Steven Puig, Vice President for Private Sector Operations at the IDB, talked about his bank's efforts to work with the private sector to finance projects that have a "development impact." He explained that the IDB has several "windows" through which to work. One window serves large companies and banks to provide financing for projects up to \$200 million. Another serves small companies, financing projects and providing technical assistance. The Multilateral Investment Fund (FOMIN) invests venture capital. The bank also provides credit and grants of up to \$10 million per project to companies with which it establishes an alliance. Puig indicated IDB interest in expanding all of these activities, especially in Central America and the Caribbean.

Minister Solorzano: In Defense of Bean Market Intervention

¶27. (U) MIFIC Minister Solorzano declared that a primary objective of the Ortega administration is to implement policies that encourage economic growth and promote exports. He stated that there is no place for politics in business; the two should be conducted independently of each other. Solorzano characterized the "harsh political discourse" between the government and opposition parties as "noise" that does not influence the true investment climate in Nicaragua. Countering previous citations of Nicaragua's poor showing in worldwide competitiveness rankings, Solorzano argued that one should differentiate between indicators that measure perception versus those that measure operations on the ground, where he thinks Nicaragua is doing well. He defended the government's effort to stabilize food commodity prices through the state-owned food commodity wholesaler ENABAS, arguing that it is the responsibility of government to ensure affordable food to its citizens. Solorzano concluded that the current administration maintains a very close relationship with the private sector, and that they routinely cooperate to resolve doing-business issues.

Comment

¶28. (SBU) Our goal in organizing this forum -- the first event of its kind that MIFIC has organized since the Ortega administration took office in January 2007 -- was to engage the GON and the private sector in a cooperative dialogue on competitiveness. In negotiating the agenda for the forum with us, MIFIC sought to avoid difficult issues such as energy, infrastructure, and rule of law. When these issues were raised, officials were quick to dismiss their relevance to Nicaragua's competitiveness. With this in mind, we believe it is important to allow the private sector to take the lead on a second event that allows for dialogue on these and other issues. The results of these two national fora and the ACF could feed into a smaller event when Secretary Gutierrez visits in late September.

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